NO. 2912

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In the United States

Circuit Court of Appeals

For the Ninth Circuit

THE FIRST NATIONAL BANK OF SAN FRANCISCO, *et al*,

Appellants,

—vs.—

DETROIT TRUST COMPANY, *et al*,

Appellees.

UPON APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION.

Brief of The American National Bank of San Francisco, et al.

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QUICK PRINT COMPANY, ABERDEEN

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The undersigned, on behalf of The American National Bank of San Francisco, Welch & Company, Slade-Wells Logging Company, United States National Bank of Portland and Humptulips Logging Company, being a majority both in number and amount of the beneficiaries under the third mortgage, beg to submit the following observations in connection with the brief filed on behalf of the appellees.

After the District Court made its order *sua sponte* (R. 295) the beneficiaries above named filed an answer to the petition of First National Bank of San Francisco *et al*, which clearly sets forth the position of said beneficiaries (R.130). These beneficiaries were not made formal parties to the appeal, but we presume that their brief will be considered by the court, provided any of the beneficiaries under the third mortgage have a right to be heard in this court.

For a statement of the facts we beg to refer to the brief filed on behalf of the appellees.

The creditors' agreement of April 30, 1915, to which the beneficiaries above named and all the appellants were parties, was entered into for the purpose of protecting the interests of the then unsecured creditors of the S. E. Slade Lumber Company. (R. 160) These creditors realized that the Lumber Company could not meet its obligations due under the first and second mortgages, and that if the first and second mortgagees foreclosed their mortgages the claims of the unsecured creditors would be worthless. It was agreed, therefore, that the creditors signing the creditors' agreement should advance, for a period of one year and provisionally for a period of two years, the necessary moneys to pay the taxes and insurance premiums on the property of the Lumber Company, and the interest due and

to become due under the first and second mortgages. These payments, aggregating about $75,000, were actually made for a period of one year, each party to the creditors' agreement advancing its proportion of the money, and in consideration of such payment Detroit Trust Company agreed not to enforce the payment of the principal of the maturing bonds during that period. The underlying purpose of the creditors signing said agreement was to secure time in which the properties of the Lumber Company, and more particularly its timber lands, could be sold to advantage and thus secure enough money to pay off the first, second and third mortgages. During the year in which the creditors made the advancements aforesaid, strenuous efforts were made by the Lumber Company and by timber brokers to sell the timber lands of the Lumber Company at a price of $2.35 per M. This was done with the consent of the beneficiaries. The efforts to sell, however, proved fruitless, and when the creditors at the expiration of the year refused to advance further moneys towards the payment of taxes, insurance premiums and interest, foreclosure of the first and second mortgages was unavoidable.

By the terms of the creditors' agreement it was contemplated that a third mortgage should be given to First Federal Trust Company as Trustee, for the purpose of securing the claims of the unsecured

creditors of the Lumber Company. This mortgage was duly given. (R. 168) By the terms of the creditors' agreement a committee of the creditors consisting of Geo. A. Kennedy of The First National Bank of San Francisco, P. E. Bowles of The American National Bank, and A. P. Welch of Welch & Company, was appointed to control and manage the claims of all creditors signing said creditors' agreement, and it was agreed that said committee and their successor or successors should have power only to act unanimously and not by a majority. (R. 166) This creditors' agreement was the working agreement under which the claims of said creditors secured under the third mortgage should be handled and protected. The third mortgage specifically provides that the Trustee shall have the exclusive right of action thereunder and be under no duty to act unless requested by the three representatives above mentioned. (R. 196) In view of these facts we are unable to see by what right the appellants herein wage their contest. They have made a contract in which they turned over their claims to a certain committee. The fact that unanimous action of the committee could in this instance not be secured, does not give them the right to overthrow the contract and proceed on their own motion. The situation is similar to cases where bondholders have agreed to

be bound by the action of certain of their number. Such contracts have been universally upheld.

Chicago R. Co. v. Fosdick, 106 U. S., 47.
Shaw v. Little Rock R. Co., 100 U. S., 612.
Canada Southern R. Co. v. Gebhard, 109 U. S., 527.
Guilford v. Minneapolis R. Co., 48 Minn., 560.
Gates v. Boston Air Line R. Co., 53 Conn., 346.
Boley v. R. Co., 64 Ill. App., 313.
Muren v. Southern Coal Co., 177 Mo. App. 600; 160 S. W., 835.
Batchelder v. Council Grove Water Co., 131 N. Y., 42; 29 N. E., 801.

Aside from the creditors' agreement we can not conceive of any valid reason why the rule of majorities should not apply. Control must rest somewhere. If a minority secured under a trust mortgage can enjoin action about to be taken by a majority in good faith, then the minority would control or there would be confusion and finally resort to the courts.

Shaw v. Little R. Co., supra.
Wheelwright v. St. Louis Transp. Co., 164 Fed., 164, 166.

The beneficiaries under the third mortgage, and the mortgagor S. E. Slade Lumber Co., are probably more vitally interested in this proceeding than the

first and second mortgagees. It is admitted on all sides that if the property is forced to sale the first mortgagee will be compelled to buy it in payment of its first mortgage. The testimony conclusively shows that if the properties of the Lumber Company are not forced to sale, but full value can be secured therefrom, enough money will be realized to pay the claims of the first, second and third mortgagees and leave an equity for the mortgagor; that only by the immediate cutting and marketing of the timber can the full value of the timber holdings of the Lumber Company be secured for the creditors; that the appointment of a receiver with power to operate is the most advantageous plan to adequately conserve the properties of the Lumber Company. (R. 257) The testimony further shows that there is constant and great danger of fire to the timber, as well as to the twelve million feet of Fir logs which were left lying on the ground by the Warren Company, and which logs are daily deteriorating in value and soon will be of no value unless brought to market and sold. (R. 260). The testimony further shows that the Warren Co. spent a great deal of money in opening up these timber lands and that numerous skid-roads have been constructed on the property, and that the money so spent will be entirely lost unless provision is made for the immediate logging of the timber. (R.260) It is also shown that there is on

the ground an extensive logging equipment belonging to the Humptulips Logging Company, which can be made available for the logging of the timber and which otherwise would be removed. It is further shown by the affidavit of Messrs. Weatherwax, (268) Ainsworth, (264) Patterson (274) and Paine (269) that it will not be necessary to pay all the debts of the Lumber Company from the moneys derived from the logging operations, but that within two or three years from the date of the making of the logging contract, providing the same is continued in force and carried out according to its terms, the indebtedness of the Lumber Company will be so materially reduced and the condition of the Lumber Company so largely improved that it will be possible to re-finance the obligations of the Lumber Company and provide for the liquidation of all its indebtedness; that within two or three years from the commencement of logging operations the value of the timber holdings of the Lumber Company will be demonstrated to such an extent to make possible the sale of the properties at a price more than adequate for the payment of the indebtedness of the Lumber Company.

Confronted with this situation the majority of the committee of creditors, as well as the majority both in number and amount of the beneficiaries under the third mortgage, thought it most advisable

from a business standpoint that a logging operation be conducted on the property, and to this scheme the first and second mortgagees consented. The minority member of the creditors' committee, as well as the minority of the beneficiaries under the third mortgage, were and are invited to join in this scheme to protect the interests of all parties concerned, but they have refused. The mortgagor joins in the scheme because only thereby can he hope to save an equity for himself.

We conceive it to be one of the highest functions of a court of equity in this case to conserve the properties of the Lumber Company and through its Receiver engage in such operations as will be to the best interests of all parties concerned.

In Alderson on Receivers, page 309 *et seq.*, it is said:

> "Notwithstanding that it was said by Lord Eldon that 'it was not the business of the court to manage or carry on from time to time a partnership of any kind, and that it was impracticable for the court to do so,' and while a receiver of the effects of a business should ordinarily proceed and wind up the establishment without delay, cases sometimes arise in which the business should be carried on by him as usual, so that the good will thereof may be secured to the purchaser and the value of the establishment realized on such sale. (*Marten v. VanSchaick*, 4 Paige, 480.) This principle

has been applied in New York in cases in which newspaper property was involved, the receivers being authorized to conduct the publication of the newspapers until they could be sold. *Dayton v. Wilkes*, 17 How. P. R., 510. So also in England an order of the Vice Chancellor appointing a receiver with power to manage and carry on a newspaper was affirmed on appeal. *Kelly v. Hutton*, 17 W. R., 425, 427. * * * In modern practice receivers are frequently authorized to carry on business to preserve its value. *Blythe v. Gibbons*, (Ind.) 35 N. E., 557. * * * It is a matter of judicial discretion as to carrying on the business of the defendant, which will not be disturbed on appeal, except in case of flagrant error and injustice. *Wilmington Star Mining Co. v. Allen*, 95 Ill., 288."

It is earnestly contended in the briefs filed on behalf of appellants that these logging operations will continue for a period of ten years, and that a court of equity will never oversee or manage the business of a private corporation for such a length of time. Our answer to this contention is that it is not contemplated that the logging operations will continue for any such period. Prior to the beginning of logging operations by Humptulips Logging Company under its contract with the Receiver, the timber lands of the Lumber Company were a dead asset. They could not be sold except possibly at a great sacrifice. It is necessary, therefore, to demonstrate the value of these timber holdings, and this

can only be done by means of a logging operation conducted for a period of two or three years. The purpose of these logging operations is to save the millions of feet of Fir logs left lying on the land by the Warren Company when it ceased operations, to save the value of the numerous and expensive skidroads constructed by the Warren Company, and the large sums of money spent by that Company in opening up the property, to prevent the further deterioration and waste of the valuable sawmill plant of the Lumber Company, to prevent the impressment of tax liens on the property and to put the timber properties in such condition that they can be sold as a going concern—*in other words, the logging operations are being conducted to preserve the value of the estate for the purposes of sale.* The contract can be cancelled by the Receiver either on his own motion or by direction of the court on sixty days' notice, and when these properties can be sold by the Receiver to advantage this action will unquestionably be taken.

It is earnestly contended by counsel for appellants that a receiver will never be appointed at the suit of a mortgagee, unless it is shown that the security is inadequate. We admit this to be the general rule, but it has no application to the case at bar. This rule is for the benefit of the mortgagor. The law is zealous in the protection of the posses-

sion of the mortgagor until after sale, unless it is shown that the possession of the mortgagor must be interfered with for the protection of the mortgagee. In this case the mortgagor consents to the proceeding. The reason for the rule failing, the rule itself fails.

Title Ins. & Trust Co. v. California Development Co., 127 Pac., 503, 504.

The majority both in number and amount of the beneficiaries under the third mortgage having requested the court for the appointment of a receiver with power to operate, the situation is analogous to a case where subsequent mortgagees request the appointment of a receiver upon the ground that their security is inadequate for the payment of their claims. It is undisputed that the security is inadequate for the payment of the claims of the third mortgagee if the property is forced to sale.

We quote from Wiltsie on Mortgage Foreclosure, 3d Ed., Vol. 2, p. 1173:

> "Subsequent mortgagees are entitled to the appointment of a receiver of the rents and profits of the mortgaged premises, on a petition showing that the mortgaged property is of less value than the amount of the encumbrances. *Buchanan v. Life Insurance*, 96 Indiana, 510; *Goddard v. Clark*, 116 N. W. 41."

We further desire to call the attention of the

court to the fact that in this case the Receiver does not incur any indebtedness whatsoever. The entire cost of the logging operations are borne by the Humptulips Logging Co., which under the undisputed testimony is financially responsible. (R. 274) From the first moneys arising from the sale of logs the Receiver must be paid the sum of $3.00 per M feet stumpage, which under all the testimony is the full market value of the timber. The question, therefore, whether or not receiver's certificates can be issued for the purpose of operating a business in the case of a mortgage foreclosure, which certificates shall be a prior lien to the mortgage indebtedness, is not before the court. The cases cited by counsel for appellants, therefore, to the effect that receiver's certificates for the operation of the property can not be issued and be made a prior lien on the property covered by the mortgages, are not in point. Were an attempt being made by the Receiver to issue receiver's certificates for a purpose other than the preservation of the property, the authorities cited by counsel would be pertinent, but not otherwise.

It is further contended that a court of equity has no power to appoint a receiver with power to operate pending a mortgage foreclosure, but that the functions of a receiver in such case are purely for the preservation of the property. In the first

place, we do not think that the powers of a court of equity are so circumscribed, and, in the next place, the power given to the Receiver in this case to enter into a logging contract is strictly for the preservation of the property and for the purpose of putting the property in such shape so that it can be sold to advantage, pay off the claims of all the mortgagees and leave an equity for the mortgagor. The confirmation of such project by the court commends itself to our minds as the exercise of a high degree of equity.

In Re Newdigate Colliery Ltd., 1 Ch., 468; Ann. Cases 1912-C, 945.

Boyce v. Continental Wire Co., 125 Fed., 740.

Atlantic Trust Co. v. Chapman, 208 U. S., 359; 52 Law Ed., 528.

Staples v. May (Cal.) 23 Pac., 711; 25 Pac., 346.

Ohio Fuel Oil Co. v. Burdett (W. Va.) 79 S. E., 667; Ann. Cases 1915-D, 1033.

Ellis v. Vernon Ice Co., 23 S. W., 858, 860.

Wagner v. Swift Iron & Steel Works, 26 S. W., 720.

In Re Newdigate Colliery, supra, the facts were that the mortgagor company issued three series of debentures secured upon its property. Default having been made in the payment of the interest, plain-

tiff, who was the holder of a large number of the first mortgage debentures, commenced an action on behalf of himself and the other first debenture holders to enforce their security against the company and the representatives of the second debenture holders. He immediately obtained an interlocutory order for the appointment of a receiver-manager of the property of the company, who proceeded to operate the mines and sell the coal. The question before the court was whether or not the receiver should cancel certain contracts which had been entered into by the company. The observations of the court with reference to the appointment of a receiver are valuable.

> "The jurisdiction of the court to appoint receivers is extremely old, but I believe the practice of appointing a manager is far more modern, and I think it has been settled that the court will never appoint a person receiver and manager except with a view to a sale. The appointment is made by way of interlocutory order with a view to a sale; it is not a permanency. Take the case of an individual mortgagee of a licensed public house. If he is merely a mortgagee of the house he has no right to interfere with the good will of the business, except so far as he may do so by taking possession of the house. He can not get possession of the stock in trade or oustanding book debts or anything relating to the business which might be obtained by the appointment of a receiver and manager. Simi-

> larly if he elects simply to take the appointment of a receiver of the property he obtains possession of the house through the receiver, and being in possession can do exactly what he likes with it, but he has no interest in the good will and he has no right to the stock in trade or book debts. If, however, he elects to take an order for the appointment of a receiver and manager of the licensed house—and it has been settled in comparatively recent years that he can do that —then I think he is in a different position. * * * But if he elects to have a manager appointed and takes upon himself, through the manager, the duty of carrying on the business, it is his duty to do nothing which will destroy, or prejudicially damage, the good will of the business at a time when it is not, and can not be, apparent that the mortgagor may not have a real interest in the equity of redemption both of the colliery itself and of the business."

In the case of *Boyce v. Continental Wire Co.*, *supra*, the court in a mortgage foreclosure case appointed a receiver and ordered him to operate the plant of the Continental Wire Company in accordance with a proposition submitted by an independent corporation with the limitation that the mortgaged property should not be liable in any way for the expense of operation. This was done against the protests of the owner of all the bonds, who made the same objections to the operation of the plant by the receiver as are here made by appellants.

In the case of *Atlantic Trust Co. v. Chapman, supra,* the court, pending a mortgage foreclosure, operated the canals of the mortgagor for a period of three years. The question before the court was whether or not the plaintiff company was liable for the expenses of the operation of the property, the property finally not having been sold for enough to pay them. The observations of the court, however, are valuable.

> "The motion for a receiver was to the end that the property might be cared for and preserved for all who had or might have an interest in the proceeds of the sale. The circumstances seem to have justified the motion, but whether a receiver should have been appointed or not was in the sound discretion of the court. Immediately upon such appointment and after the qualification of the receiver, the property passed into the custody of the law, and thenceforward its administration was wholly under the control of the court by its officer or creature, the receiver. *Booth v. Clark*, 17 How, 322-331; 15 Law Ed., 164, 167. * * *
>
> Still further, the court—if it had been proper under all the circumstances, to pursue such a course—could have refused to operate the canals in question at all and required the parties to proceed to a final decree of foreclosure and sale at the earliest practicable moment. But none of these things were done. Under the responsibility imposed upon it by law, the court determined to carry on the business of the Canal & Irrigation Company for a time."

Apart from the inherent power of equity to appoint receivers, in this case we have also statutory authority. The Washington Statute provides that a receiver may be appointed:

> "6. And in such other cases as may be provided for by law, or when, in the discretion of the court, it may be necessary to secure ample justice to the parties."

Sec. 741, Rem. & Ball.'s Code.

This statute applies with particular force to the present situation.

In this connection see *Boothe v. Summit Coal mining Co.*, 55 Wash. 167, 176.

In conclusion we desire to direct the attention of the court to the necessary result if the Receivership is now terminated and the first mortgagee ordered to proceed to a forced sale of the property. The first mortgagee will in all probability buy in the entire property for the satisfaction of its claim. This will leave in the beneficiaries under the third mortgage the naked right to redeem. During the period of redemption the property can not be logged. Aside from the constant danger of fire to the timber, the millions of feet of logs now on the lands of the Lumber Company will probably so have deteriorated that they will be valueless. A sale of the property at a price sufficient even to pay the beneficiaries un-

der the third mortgage a small amount on their claims seems not to be within the range of the probabilities. To make it possible to secure any amount toward the payment of their claims the beneficiaries under the third mortgage would be obliged to pay the claims of the first and second mortgagees, which is a very considerable sum. It is highly improbable that any of these beneficiaries would consider the redemption of this property from the first and second mortgages and assume the additional risk of getting their redemption money back. The mortgagor would unquestionably lose his entire equity.

The appellants have at no time suggested or offered any plan whereby the interests of the beneficiaries under the third mortgage can be better subserved than under the present plan, or at all, and we may rightly inquire of them now what plan do they offer. The appellants cannot possibly be injured under the plan as now devised and in operation. Under it the Receiver incurs no expenses, the timber is logged under his supervision and direction by Humptulips Logging Co., and the Receiver gets from the first moneys the full value of the stumpage, to-wit, $3.00 per M, and if the log market justifies, obtains in addition all sums over and above the stumpage of $3.00, the logging cost and compensation to the Logging Company. The appellants have failed to point out wherein any possible loss can ac-

crue to them by reason of the continuation of these logging operations for a period of two or three years, and until the property can be advantageously sold.

We believe that the equities of the case were fully and fairly stated by the lower court in its memorandum decision (R. 124) and that the decision of the lower court should be sustained.

Respectfully submitted,

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